



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
HOWARD AND)
MARGA **RET** RICHARDSON)

Appearances:

For Appellants: Marvin A. Bernay
Certified Public Accountant

Ralph M. Wolveck
Certified Public Accountant

For Respondent: Karl F. Munz
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Howard and Margaret Richardson against proposed assessments of additional personal income tax in the amounts of \$118.52, \$302.20, and \$354.48 for the years 1969, 1970, and 1971, respectively.

Appeal of Howard and Margaret Richardson

The issue presented is whether certain expenses incurred by Howard Richardson (hereafter appellant) were deductible either as ordinary and necessary business expenses or as expenses paid for the production of income.

For several years prior to 1969 appellant was the general manager of a car dealership located in Covina, California. Appellant terminated his association with the Covina dealership in 1969. Shortly thereafter, appellant received a communication from General Motors Corporation stating that appellant would be awarded a Chevrolet franchise if he could acquire appropriate property for a dealership in Newport Beach, California. Appellant immediately commenced negotiations to acquire property in Newport Beach upon which to conduct business under the franchise. However, appellant was unable to acquire property for that purpose until 1971. In November 1971, Howard Chevrolet, Inc., was formed to operate the Newport Beach dealership. The corporation commenced business in September 1972, with appellant as president and major shareholder.

In connection with his activities relative to the acquisition of property in Newport Beach and the organization of Howard Chevrolet, Inc., appellant incurred **substantial** expenses during 1969, 1970, and 1971. In his joint California personal income tax returns for those years appellant deducted the respective expenses on an amortized basis. In support of the deductions appellant submitted sole proprietorship profit and **loss** statements which **listed** the expenditures as "organizational expenses." Also, on each of the returns for the three years in question appellant stated that the Newport Beach dealership would commence business in the subsequent year.

Respondent disallowed the claimed deductions on the basis of its determination that the expenses were not incurred by appellant in carrying on a trade or business. Accordingly, respondent added back the amortized amounts to taxable income, recomputed the tax, and issued the proposed assessments which gave rise to this appeal.

Appeal of Howard and Margaret Richardson

Appellant's primary contention is that he was engaged in a sole proprietorship during the income years under appeal, and that the expenses in question are deductible as ordinary and necessary business expenses pursuant to section 17202 of the Revenue and Taxation Code. In the alternative, appellant contends that the expenses are deductible pursuant to section 17252 of the Revenue and Taxation Code as expenses incurred for the production of income. For reasons to be stated hereinafter, we hold that appellant is not entitled to the claimed deductions under either statute.

Section 17202 of the Revenue and Taxation Code provides, in pertinent part, that "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade-or business. " (Emphasis added.) With respect to appellant's first contention, the record contains no evidence that the expenses were incurred in carrying on a trade or business. Appellant paid the expenses, following his severance of connections with the Covina dealership, to enable him to conduct business through a corporate dealership in Newport Beach. The corporate dealership did not commence business until after the years in issue. Expenditures made preparatory to the establishment of a business do not constitute expenses incurred in carrying on a trade or business. (Werner Abegg, 50 T.C. 145, 154; Roy L. Harding, T. C. Memo., June 29, 1970; William E. Day and Geneva Day, T. C. Memo., Nov. 15, 1956; Appeal of the Estate of Samuel Cohen, et al., Cal. St. Bd. of Equal., Nov. 17, 1964.)

Appellant cites Snow v. Commissioner, 416 U. S. 500 [40 L. Ed. 2d 336], for the proposition that "pre-opening" expenses of a business are deductible by an individual taxpayer. However, in that case the Court held that section 174(a)(1) of the Internal Revenue Code of 1954,^{1/} which allows a deduction for "experimental expenditures

^{1/} Section 174 of the Internal Revenue Code of 1954 is substantially similar to section 17223 of the California Revenue and Taxation Code.

Appeal of Howard and Margaret Richardson

which are paid or incurred by [the taxpayer] during the taxable year in connection with his trade or business, " was intended to encompass expenditures attributable to research and experimentation which are incurred by an upcoming business about to reach the market with a new product. The Court expressly noted the distinction between research and experimentation expenses incurred "in connection with" a trade or business and expenses incurred "in carrying on" a trade or business. (Snow v. Commissioner, supra, 416 U. S. at 503.) In the instant appeal, the expenditures in question were not incurred for purposes of research and experimentation. Thus, the decision in Snow is clearly not applicable to the factual situation presented by this appeal.

Appellant's alternative contention is that the expenses in question are deductible pursuant to section 17252 of the Revenue and Taxation Code. That section allows an individual taxpayer to deduct ordinary and necessary expenses paid for the production or collection of income. The statute is identical to its federal counterpart. (Int. Rev. Code of 1954, § 212.) Accordingly, federal court decisions construing the federal statute are entitled to great weight in applying the state provision. (Meanley v. McColgan, 49 Cal. App. 2d 203, 209 [121 P. 2d 45]; Appeal of Glenn M. and Phyllis R. Pfau, Cal. St. Bd. of Equal. , July 31, 1972.)

The federal authorities have uniformly disallowed a deduction, based upon section 212 and its predecessors, for expenses incurred by an individual taxpayer for the purpose of establishing a new trade or business. (J. W. York, 29 T.C. 520, 528, rev'd on other grounds, 261 F.2d 421; Morton Frank, 20 T.C. 511, 514; Dwight A. Ward, 20 T.C. 332, 343, aff'd, 224 F.2d 547; Theodore R. Price, T.C. Memo. , Dec. 23, 1971.) The decisions are based upon the "distinction between allowing deductions for the expense of producing or collecting income, in which one has an existent interest or right, and expenses incurred in an attempt to obtain income by the creation of some new interest. " (Morton Frank, supra.) In the instant case, the expenses in question were incurred to enable appellant to obtain the Chevrolet franchise and establish the Newport Beach dealership. The expenses were not incurred for the production of income from property in which appellant had an existing interest. Therefore, the expenses are not deductible under section 17252 of the Revenue and Taxation Code.

Appeal of Howard and Margaret Richardson

Finally, in arguing that the expenditures in question are deductible as personal business expenses, appellant has apparently failed to distinguish his identity as an individual taxpayer from the identity of the corporation which he established. Expenses incurred to promote a corporate enterprise are not deductible by individual taxpayers. (Dwight A. Ward supra, 20 T. C. at 343.) Such expenditures ~~are considered~~ capital contributions and become part of the promoter's cost basis for his stock interest in the corporation. (Dwight A. Ward, supra, 20 T. C. at 344; Sam C. Evans, T.C. Memo., Oct. 15, 1974.)

In accordance with the views expressed above, we conclude that respondent's action in this matter was proper and must be sustained.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Howard and Margaret Richardson against proposed assessments of additional personal income tax in the amounts of \$118.52, \$302.20, and \$354.48 for the years 1969, 1970, and 1971, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of February, 1976, by the State Board of Equalization.

Dwight A. Ward, Chairman
George J. Healy, Member
Paul J. Kear, Member
_____, Member
_____, Member

ATTEST: *W. W. Donlop*, Executive Secretary